BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE
THE DELAWARE ENERGY OFFICE
THE OFFICE OF MANAGEMENT AND BUDGET
AND THE CONTROLLER GENERAL

IN THE MATTER OF THE INTEGRATED RESOURCE PLANNING FOR THE PROVISION OF STANDARD OFFER SERVICE BY DP&L POWER & LIGHT COMPANY UNDER 26 *DEL. C.* §1007(c) & (d): REVIEW AND APPROVAL OF THE REQUEST FOR PROPOSALS FOR THE CONSTRUCTION OF NEW GENERATION RESOURCES UNDER 26 *DEL. C.* §1007(d) (Opened July 25, 2006).	)	PSC DOCKET NO. 06-241

CONECTIV ENERGY SUPPLY, INC.'S
RESPONSE TO THE FINAL STAFF REPORT

I. Introduction.

Throughout this proceeding, Conectiv Energy has consistently urged the Commission and the State Agencies to make sure that the most cost-effective power supply is made available to Delmarva and its ratepayers. In response to Delmarva's initial RFP, Conectiv Energy submitted a proposal for a 177 MW gas-fired facility that was judged, by both Delmarva's and the Staff's consultants, to be the least costly of the three proposals submitted. When the State Agencies decided that the primary source of supply should be provided by wind, Conectiv Energy sought the opportunity to reduce the cost of wind-powered supply by bidding competitively against Bluewater Wind. When the State Agencies denied Conectiv's request to compete against Bluewater for the wind component of the hybrid, Conectiv Energy submitted a proposal for back-up service which, when combined with the wind project, has been found, in both the Staff's Final

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Report and in the Pace Report, to be more cost-effective than either a combination of the wind project and NRG's proposal or the wind project alone.[1]

In this continuing spirit of advocating the most cost-effective use of Delmarva's and ratepayers' funds, Conectiv Energy submits that the State Agencies must refrain from acting unless it is consistent with the criteria of EURSCA and minimizes the risk to be borne ultimately by Delmarva's ratepayers.

II. The State Agencies Should Ensure That Any Rate Increase Used To Finance Emissions Reduction Is Employed In The Most Cost-Effective Manner.

EURSCA delegated to the four State Agencies the task of soliciting proposals for power supply for Delmarva and determining which one results in "the greatest long-term benefits . . . in the most cost–effective manner."[2] EURSCA set out specific criteria, including price, price stability, innovative technologies, and impact on the environment, to guide the State Agencies in their deliberations. These principles, and Bluewater Wind's failure to satisfy them, are echoed in the recent submission of the Public Advocate, as well as in the Staff's own October 29, 2007 report.

After well over a year of proposals, negotiations and public testimony, one thing is clear – there is a segment of Delmarva's ratepayers that is willing, even anxious, to pay higher rates in order to reduce emissions associated with their power supply. The best indication of exactly how much more these customers are willing to pay is evidenced by their support for the wind project which will increase rates over and above purchases

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1 PSC Staff Report on the Term Sheets For Proposed Power Sales to Delmarva Power ("Staff Report"), Appendix A, p. 37; Independent Economic Assessment of Proposed Bluewater Offshore Wind Farm ("Pace Report"), p. 2.

2 26 *Del. C.* §1001, *et seq*. (the "EURCSA").

from the market (referred to in the Pace Report as the "Green Premium") by a net present value of $398 million,[3] $780 million,[4] or more.

If the State Agencies decide that the emission reductions available from construction of the wind project justify the costs to ratepayers, they will be taking advantage of an historic opportunity to commit significant ratepayer-provided funds to address a critical environmental issue. Conectiv Energy submits that they, before the State Agencies make such a commitment of ratepayer funds they should be absolutely sure that they are being used in the most efficient manner. Conectiv Energy further submits that the State Agencies will be wasting this opportunity if they approve the wind project at the expense of less costly opportunities to achieve the same benefits or at the expense of opportunities to achieve even more benefits at the same cost as the wind project, particularly if such opportunities are not even explored before they are summarily dismissed.

From this perspective, the actual cost of the wind project becomes almost irrelevant. The real question becomes whether other options are available to achieve the same benefits at lower costs or to achieve greater benefits at the same costs. To that end, Conectiv Energy cites to the Pace Report which found that Bluewater's off-shore wind project is $400 million more costly, on a net present value basis, than on-shore wind available from projects in PJM-West.[5] While there are those who would like to believe that an off-shore wind farm would reduce fossil fuel generation in Delaware – especially from the Indian River Plant – the fact is that the location of the wind farm will have no impact on whether or not the Indian River Plant will operate. PJM dispatches generating

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3 Staff Report, Appendix A, p. 37.

4 Pace Report, p. 9.

5 Pace Report, p. 9.

units on the basis of costs, and Indian River (a low cost coal fired plant) will operate virtually all the time whether a wind farm is added to the grid off the shore of Delaware or on-shore in PJM-West. Thus, the environmental impact of both the off-shore project and any on-shore opportunity are the same.

In addition, both the off-shore project and the on-shore wind opportunity will have the same impact on the availability of power supply in Delaware. As indicated in both the Staff Report and in the Pace Report, use of the proposed Conectiv Energy plant in southern Delaware will firm up the supply from the off-shore wind project, provide a new source of power in the southern part of the state and reduce costs below the cost of the wind project alone.[6] There is no reason to believe that the same impact will not be available if the Conectiv Energy plant is selected to back-up on-shore wind from PJM-West.

On-shore wind generation also has the following benefits not available from off-shore wind: (1) on-shore wind could be in service by 2010 or 2011, a full four years before the off-shore wind facility is scheduled to be in service; (2) because of the numerous developers of on-shore wind facilities there is likely to be real price competition and numerous alternatives regarding the term of the agreement, the turbine models and the levels of experience; and (3) the potential to award smaller contracts to more that one developer provides the benefits of diversity of suppliers and locations.

Thus, if the off-shore wind project is selected, the State Agencies will be committing Delmarva and its ratepayers to pay $400 million in additional funds to achieve the same benefits that would be obtained from an on-shore wind farm. Put another way, by selecting the off-shore wind project, the State Agencies will be foregoing

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6 Staff Report, Appendix A, p. 37; Pace Report, p. 9.

tremendous opportunities for additional benefits that might be available from the $400 million saved by purchasing on-shore wind generation instead of power from the off-shore wind project. One need look only as far as the Sustainable Energy Utility ("SEU") legislation passed earlier this year to recognize the potential impact that using the additional $400 million in the most cost-effective manner might have.[7]

In the SEU, the legislature made a mere $30 million dollars available for energy conservation and energy cost reduction programs. The legislature went on to create a mechanism for prudently allocating the funds among a number of programs including energy efficiency, solar lifeline, affordable energy, green buildings and clean vehicles and customer-sited renewable energy.[8] The SEU projects 30% energy savings for participants in the program. Thus, if the State Agencies, the Commission or the legislature decides that Delmarva and its customers should pay a price equal to the off-shore wind project, the potential benefits in emission reductions and energy costs savings that could be gained by applying the $400 million difference between on-shore and off-shore wind to an SEU type program would have to be staggering.

III. If the State Agencies Decide to go Forward with the Wind Project, Conectiv <u>Energy's Back-Up Proposal Should be Selected.</u>

The wind project, if developed, will require two components of back-up service:

- Capacity, consisting of the 195 MW difference between the 105 MW provided by wind and the 300 MW block being acquired by Delmarva; and
- Energy, consisting of the difference between the MW provided in any hour by wind and the 300 MW block.

If no dedicated back-up facility is constructed, Delmarva would have to acquire the 195 MW of capacity from the market and it would have to acquire the energy as

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7 Senate Bill No. 18.
8 29 *Del. C.* §8059, *et seq.*

needed each hour at LMP. This is the reference case analyzed by the Staff Consultant using a conservative adjustment and results in a net present value increase over market prices of approximately $398 million.[9]

Conectiv Energy and NRG proposed very similar methods of meeting the wind project's back-up requirements. With respect to capacity, both offered to sell 195 MW of capacity at a fixed price for the 25 years of the agreement. With respect to energy, neither bidder proposed to operate its facility to match the back-up energy requirements of the wind project. Instead, both offered to meet the energy requirement from the market and to provide a price hedge during hours when LMP exceeds the operating costs of their respective facility. Thus, the difference between the two back-up proposals is equal to the sum of (i) the difference between the proposed capacity prices and (ii) the difference between the benefit provided by the price hedges.

The capacity prices offered by the back-up suppliers were as follows:

- NRG: $23.85/kW-month (consisting of a fixed price of $19.25/kW-month and an additional estimated $4.60/kW-month for gas transportation).[10]
- CESI: $11.27/kW-month (consisting of a fixed price of $10.65/kW-month and an additional $0.62/kW-month adder for the estimated cost of interconnection).[11]

NRG's capacity charge is higher than CESI's by $29,437,200 per year.[12] The impact of the capacity price differences could be mitigated or exacerbated by the impact of the difference between the benefit provided by the price hedges. According to the Staff Report, the back-up provider will provide 1,522,429 MWH of back-up energy in

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9 Staff Report, Appendix A, p. 34.
10 Staff Report, Appendix A, p. 6.
11 Staff Report, Appendix A, p. 8.
12 ($23.85 kV-month – $11.27 kW-month) * 195,000 kW * 12 months

each year.[13] The benefit of each proposal's price hedge depends upon how many of those MWH are subject to the price hedge and what level of benefit is provided by such price hedge when it is in effect.

Between the two, Conectiv Energy's price hedge would tend to have a greater benefit than NRG's because of the following:

- Conectiv Energy's project has a two hour minimum run time rather than the six hour minimum run time of NRG's and, as a result, Conectiv Energy's price hedge is likely to be effective during numerous short peak usage periods when NRG's will not.

- NRG has proposed a start charge and a fuel charge associated with its project's five hour cold start. There are no such start charges associated with Conectiv Energy's project which has a 10 minute start time.

- Conectiv Energy's project can be operated multiple times in the same day while NRG's project can only be operated once each day. As a result, only Conectiv Energy's price hedge is likely to be effective for hours during a second peak usage occurring on the same day.

In contrast, NRG's price hedge might have a greater benefit than Conectiv Energy's because of the following:

- NRG's project runs at a lower heat rate and, thus, would provide a greater benefit than Conectiv Energy's when the price hedge is in effect.

- NRG's hedge is indexed to gas costs year round while Conectiv Energy's hedge is indexed to fuel oil during the winter months (a time when LMPs tend to be lower and, thus, less likely to be subject to the price hedge).

- NRG provides a price hedge for all hours in which back-up service is provided while Conectiv Energy does not provide a hedge for the amount of the back-up service which exceeds 195 MW (approximately 5% of total back-up MWH).

It is unclear from the Staff Report exactly how the Staff's Consultant calculated the relative merits of the two proposals' price hedges. However, while it may have found that the differences in price hedges favored NRG, it must also have found that that

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13 Staff Report, Appendix A, p. 11.

difference did not fully offset the impact of NRG's much larger capacity price. Specifically, the Staff's Consultant concluded that NRG's proposal would increase costs to ratepayers by a net prevent value of $21 million more than simply relying upon the market for back-up to the wind project. In contrast, the Staff's Consultant found that Conectiv Energy's proposal would reduce costs to ratepayers by a net present value of $53 million when compared to reliance upon the market for back-up.[14]

However, the $74 million difference in costs is not the only reason that the Conectiv Energy back-up proposal is preferable to NRG's. NRG's proposal has a major contingency that is not a part of Conectiv Energy's. Specifically, NRG's proposal is contingent upon construction of a gas pipeline crossing under the Chesapeake Bay. If the gas pipeline crossing is not complete by 2013, NRG has the right to simply walk away from its contract with Delmarva without penalty.[15]

The Conectiv Energy proposal is not dependent upon the Bay crossing. Conectiv Energy proposes to use upgrades of existing gas pipeline facilities.[16] Conectiv Energy's proposal is, thus, unconditional with respect to the availability of gas supply.

The Staff in its Report suggested that siting would be a concern for the Conectiv Energy project because it did not yet own property rights.[17] At the time that the Term Sheets were submitted, Conectiv Energy had an option on a site near Delmar that could be used for the project. It hoped to obtain a site near Bridgeville, which if acquired, would reduce costs for Conectiv Energy, but would have no impact on the price paid by Delmarva. In order to avoid any confusion, Conectiv Energy wants to make clear that it

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[14] Staff Report, Appendix A, p. 37.
[15] Staff Report, Appendix A, p. 53.
[16] Staff Report, Appendix A, p. 8.
[17] Staff Report, p. 22.

is prepared to use the site near Delmar upon which it holds an option. Between now and the time that Conectiv Energy starts construction it may arrange for an alternative site. However, the selection of such an alternative site would have no impact on the service provided or the cost of such service. Thus, siting of the Conectiv Energy project is not an issue.

IV. Conectiv Energy Remains Prepared to Provide Service Under its Term Sheet Whether or Not the Off-Shore Wind Facility is Approved.

Conectiv Energy recognizes Staff's continuing concern regarding the need for new generation in southern Delaware.[18] The solicitation for a back up provider for the off-shore wind project could also be viewed as a solicitation for a supply of new gas fired generation in the southern part of the state to meet the Staff's concerns whether or not the off-shore wind project is approved. Alternatively, it could be viewed as a solicitation to back up on-shore wind generation to the extent that such an option is selected for Delmarva and its ratepayers. In either event, Conectiv Energy submits that both the Staff Report and the Pace Report concluded that Conectiv Energy's proposed facility is more cost effective than NRG. Therefore, Conectiv Energy wants to make it clear that, if the State Agencies wish to move forward with new gas-fired generation in the southern part of the state, either for reliability purposes or to back up on-shore wind to be purchased at some point in the future, Conectiv Energy remains ready, willing and able to provide such service from a new plant under the terms of its Term Sheet.

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18 Staff Report, p. 21.

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V. Conclusion

The State Agencies have, for more than a year, been engaged in a unique process[19] conducted pursuant to a very restrictive statutory mandate. Much has been learned throughout this process – the most important of which may be the willingness of a segment of Delmarva's ratepayers to pay increased rates for "green energy". However, the restrictions of the statutory mandate actually limited the ability of the State Agencies to fully investigate and consider all opportunities for the acquisition of green energy on a cost effective basis.

Under such circumstances, and in light of the significant risks facing the State and its ratepayers, the public interest is best served by ending this process without awarding a contract for the off-shore wind project and exploring the wide range of available "green" alternatives in another proceeding in accordance with principles of the Administrative Procedures Act, the Commission's rules, and due process.

Moreover, should the State Agencies determine to proceed with the wind project, Conectiv Energy's back-up proposal should be selected because it is the most cost-effective and reliable proposal, unhampered by the contingencies attendant to the NRG proposal.

[19] Conectiv Energy challenged the way in which this process was conducted and incorporates by reference the arguments set forth in its June 11, 2007 Petition for Rehearing and Reconsideration as if fully set forth herein, and reserves all claims, arguments and defenses.

Respectfully Submitted,

Dated: November 13, 2007

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